How Housing Credits Work

The Housing Credit is a federal tax credit. It was created by President Reagan and Congress in the Tax Reform Act of 1986, because Congress was concerned that the tax preferences for low-income rental housing available under prior law were "not effective in providing affordable housing for low-income individuals." Congress believed a more efficient mechanism for encouraging the production of low-income rental housing could be provided through a low-income rental housing tax credit.

Since its creation 29 years ago, the Housing Credit has proven to be the most successful affordable rental housing production program in history. This success is visible in Virginia, where today there are 969 actively leasing properties (89,050 apartments) funded by federal Housing Credits allocated by the Virginia Housing Development Authority (VHDA). These apartments serve low-income families, people with disabilities, the elderly and the homeless in urban and rural Virginia.

Here's how the program works.

1. Federal regulations allow each state's housing finance agency to work within broad guidelines and tailor the Housing Credit program to best address that state's needs. The program encourages investors to finance apartments for low-income residents at restricted rents. Each year, each state gets a per capita allocation of Housing Credits. For Virginia in 2015, the allocation was $2.30 per capita for a total of $19.1 million. In addition, a state may request a share of the national pool of unused credits from other states. The credits generate approximately twice their value in additional investment.

   Eligible development types and corresponding credit rates include: 9 percent for new construction or substantial rehabilitation of developments not federally subsidized or financed with tax-exempt bonds; and 4 percent for new construction, substantial rehabilitation or acquisition of developments that are federally subsidized with tax-exempt bonds. The actual tax credit rate, recalculated monthly by the IRS based on Treasury Department interest rates, is set at the prevailing rate either when the developer signs the contract with the housing finance agency or when the finished project is ready for occupancy. That rate represents the percentage of qualified project costs investors can claim against their tax liability each year for 10 years.

2. Each state's housing finance agency — VHDA in Virginia — develops a qualified allocation plan (QAP) to give priority to its most pressing low-income housing needs. It then holds public hearings on the QAP and coordinates priorities with other housing programs.

3. VHDA evaluates which apartment developments, among the many proposed, best meet the QAP. Virginia's QAP establishes a competitive system centered on the allocation of points earned for meeting various criteria. Points are awarded for a variety of housing needs characteristics that include readiness; location of the proposed development

in a Qualified Census Tract and revitalization area; development characteristics such as EarthCraft or LEED green building certification; resident population characteristics; sponsor's experience; and efficient use of resources.

In addition, bonus points are awarded for a commitment to impose income and rent limits on the low-income housing units throughout — as well as beyond — the 30-year extended use period. Even when all applicants meet the QAP standards, fewer than half are able to be funded, with about a third of all Housing Credits awarded to non-profit organizations.

4. VHDA scrutinizes costs and financing estimates in the proposals it selects, and limits developer and builder profit, providing only enough Housing Credits to make it possible to rent the apartments to low-income families at restricted rents.

5. After adjusting the developer's estimates, VHDA allocates the credits to the developer, who then sells them for cash to investors who want to reduce their federal taxes.

6. Developers use professional tax credit syndication firms to market Housing Credits to the largest possible number of investors to get the highest possible price. (Non-profit organizations syndicate a third of all Housing Credits.)

7. Money from selling Housing Credits acts as the developer's equity in the property and reduces the mortgage needed to build or renovate the apartment complex. These savings are what make restricted, lower rents for low-income residents possible.

8. The developer uses the cash from selling the credits and mortgage proceeds to buy materials and hire labor for construction. VHDA ensures that developers begin construction promptly and finish within a specified time or require that the credits be returned for re-allocation.

9. When the apartment complex is ready to be occupied, VHDA reviews the costs and funding sources again, and reduces the Housing Credits if fewer are needed than were first approved.

10. In order to ensure the ongoing quality of the rental property, as well as compliance with the program, VHDA continuously checks resident rents and incomes, inspects property conditions and notifies the IRS about any ineligible residents, excessive rents or significant physical defects. The IRS can recover any Housing Credits claimed by investors on apartments that are out of compliance.

    Investors have a strong stake in keeping an apartment complex in compliance. They can claim the Housing Credits for 10 years, but only as long as their apartments remain in good condition and are rented to low-income residents at restricted rents. However, most developers in Virginia agree to hold rents at affordable levels for 30 years.